

United States Senate  
Committee on Finance

The Honorable Max Baucus (Montana), Chairman

Testimony of Steven L. Holland, Director  
Montana Manufacturing Extension Center

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Good morning Chairman Baucus, Ranking Member Grassley, and distinguished members of the Committee. I would like to begin by thanking you for this opportunity to share our views and perspective on international trade issues facing America's small manufacturing community. These views are derived from the Montana Manufacturing Extension Center's experience working with well over 500 small manufacturers over the last 10 years; the collective knowledge of the Montana District Export Council; input from members of the Montana Chamber of Commerce; and over 30 years of personal experience in manufacturing.

My name is Steve Holland; I am the director of the Montana Manufacturing Extension Center (MMEC) which is a College of Engineering Center at Montana State University (MSU), the state's land grant campus in Bozeman, 100 miles north of Yellowstone National Park.

MMEC's mission is to "help manufacturers be successful" using professional field staff with extensive private industrial backgrounds to work on-site with company owners, managers and workforce to identify and implement appropriate manufacturing processes, business systems, technologies and training. Founded in 1986 as an EDA University Center our operations grew dramatically in both capacity and capability in 1996 when we also became a NIST MEP Center (National Institute of Standards and Technology – Manufacturing Extension Partnership) a network of 350 centers in located in all 50 states and in Puerto Rico. MMEC and its MEP counterparts have an intimate knowledge of the challenges faced by small manufacturers. MMEC has developed a strong network of complementary resources including several organizations that offer international trade expertise such as the U.S. Commercial Services, Montana World Trade Center, and Montana Export Assistance Center to help our customers succeed.

In addition to serving as MMEC's director, I have leadership roles on several national boards: American Small Manufacturers Coalition; American Industrial Extension Alliance and University Economic Development Association. I also serve on the Montana District Export Council and the Montana Chamber of Commerce Board. I have been on several

congressionally led trade missions traveling to New Zealand, Australia, Spain, Germany, Ireland, South Korea, China and most recently to the Lombardy region of Italy.

Turning to the subject matter of your hearing today, let me first say that the issues facing manufacturers in Montana are very similar to issues facing small manufacturers in every state. Transportation costs and workforce availability are particularly onerous in my state but affect most small companies' ability to compete in both domestic and international markets. I am comfortable, therefore, using Montana as a proxy for small rural manufacturers and for more than 350,000 small and medium sized manufacturers in the U. S.

This document is organized in four sections. The first discusses why manufacturing is important, the second summarizes trade issues that are well known and at the forefront of your efforts. The third section addresses the possibilities afforded us by increasing exports. The fourth section focuses on recommendations that are specific to strengthening small manufacturers' ability to export and in need of additional attention. In that section you will find five specific recommendations:

1. Support innovation as foundational to U.S competitiveness
2. Ensure that trade agreements have transparency for standards and localized regulation
3. Support creation of an export guide and evaluation tool
4. Enable more and affordable assistance to compete in foreign markets
5. Encourage and sponsor trade missions

#### **Manufactured Exports Create Jobs**

The 2006 National Export Strategy notes that "exporting is an important pillar of U.S. economic growth" because "one in five manufacturing jobs depends on exports. Firms engaged in international trade ... offer higher wages and benefits." Clearly, it is to the benefit of the U.S. to invest in helping firms export, not only because successful firms yield a return on the Federal investment by paying more taxes, but also because higher wages and benefits provides more jobs that include health insurance which results in coverage for more American families. Manufacturing tends to pay higher wages than other industries, which means our citizens can enjoy a higher standard of living. The National Export Strategy states the conclusion succinctly: "For the United States to remain competitive, we must engage more of the American business community in the global economy."

The Office of the U.S. Trade Representative concurs, reporting that "manufacturing exports support an estimated 5.2 million jobs in the United States... Agriculture exports (including processed food) support 836,000 jobs in the United States. Manufacturing jobs are good paying jobs. U.S. jobs supported by goods exports pay an estimated 13% to 18% more than the U.S. national average. Typically, manufacturing jobs include good benefit packages which include health insurance. Further reduction in trade barriers will spur the creation of more, higher paying jobs in the U.S. Most of those jobs would include health insurance which would reduce the number of uninsured or underinsured families."

### **General Export Issues**

Large and small manufacturers who export deal with a substantial number of barriers and issues. Several of these overarching issues are presented here because they matter to SMEs. Clearly, these issues need to be resolved for the entire manufacturing community.

- **Trade agreement enforcement.** Some of our trading partners allegedly manipulate their currency, provide illegal subsidies to their firms, fail to enforce piracy laws and make little effort to protect intellectual property. Enforcement of agreements and the removal of illegal trade barriers needs to carry the same priority as trade negotiations. The District Export Council web site notes "America's small and medium manufacturers (SMMs) can compete in the global economy if the playing field is level, and that's why free trade agreements (FTAs) are so important." Perhaps a better name would be Fair Trade Agreements. But setting that minor point aside, I agree completely. However, the best agreement is worthless if the parties don't comply with its terms. Partners who willfully violate agreements are unethical. They are stealing from the faithful partner which is not a level playing field. If we make the effort to reach an agreement, let us also make the effort to assure our partners are doing what they said they would do. We are significantly disadvantaged when countries manipulate currency, fail to enforce intellectual property agreements, turn a blind eye to piracy, fund illegal subsidies, and erect other trade barriers.

We need to take action against countries that intentionally undermine good faith trade agreements. Why would we continue to do business with unethical and deceptive partners? The goal should be fair trade. We certainly want access to foreign markets. After all, trading, by definition, requires at least two willing partners. Each partner does what they do best and most efficiently. Each partner gains value, or they wouldn't trade.

- **Cost structure.** U. S. exporters face a cost structure disadvantage in some markets. Our health care and litigation systems are two examples.

U.S. manufacturing jobs typically have good benefit packages including health care. But the current system for healthcare coverage puts too much burden on the American company. We need to consider the effect the system has on our ability to compete overseas, and make corrections. We need to do this without reducing our standard of healthcare.

The litigious nature of the U.S. system contributes to the cost disadvantage for U. S. based businesses, draining resources and diverting managerial focus. Legal reforms that reduce or eliminate "frivolous" law suits and excessive settlements are needed.

- **Trade imbalance.** Warren Buffett has suggested we achieve balanced trade by issuing "import certificates". He proposes we issue an import certificate to U.S. exporters in proportion to their exports. These certificates would be traded in the market place. To sell to the U.S., any foreign company would have to obtain

import certificates that match the value of their shipment. Like magic, we'd have balanced trade. I don't fully understand the implications, but I believe a radical approach like this would not be needed if we level the international trading field. Fair Trade is all U.S. Manufacturers need to balance trade.

- Human rights. We need to step up our efforts to enforce basic human rights initiatives. If we truly abhor child labor, forced labor, and slave labor, we can do nothing less. We lead the world in workforce health and safety. Generally, safe and healthy practices are considered a cost advantage and an ethical requirement. However, when a trading partner places no value on human life we violate our own ethical standards by continuing to do business with him.
- Global pollution. Differing environmental regulations hamper commerce within the United States. For example, California's environmental regulations are very different than Montana's. But sorting through the regulations becomes exponentially more complicated when we move into the international arena.

Many countries have very lax environmental regulations compared with ours. It is not a level playing field when we put rigid environmental controls on domestic manufacturers and then allow imports that turn a blind eye to pollution. We now understand that pollution on the other side of the globe impacts the entire world. For example, air and water pollution in China deteriorates the air and ocean quality in the United States. Our air and seas become homogenous; we breathe what our trading partners breathe. Our collective pollution enters our food chain. Weather is global. Pollution is global.

### **Untapped Potential in Manufacturing Exports**

My recent participation in a trade mission to Italy rekindled the conviction that opportunities to expand markets internationally are very real for small American companies. A common misconception is that America's small companies can't sell in world markets and only large multinationals can. Yet in 2001, the latest year for which data is available, 97% of all U.S. exporters were small and medium-sized enterprises (SMEs, firms having fewer than 500 employees), accounting for nearly one in every three dollars of U.S. exports.

What's most relevant here is that 70 percent of all U.S. firms exporting actually have fewer than 20 employees. In Montana 84 percent of the state's 2,300 manufacturers employ fewer than 20 people, so developing export potential for rural SMEs is realistic.

Two-thirds of SMEs that export currently sell to just one foreign market, and nearly half to just four. In Montana, four markets attract most of the export business, with Canada at roughly 50 percent followed by Japan and Germany each with 10 percent and Taiwan with just over 6 percent. A real window for capturing market share around the world is in the offing as domestic demand surges in many developing nations and skyrockets in China. Remember: 96 percent of the world's consumers live outside of the United States!

There is potential for SMEs to grow exports dramatically. For example, Montana manufacturing firms exported approximately \$510 million in 2005, up a whopping 76% since 2002. Yet, Manufacturing exports in the state account for only about 6.5 percent of the total value of manufacturing shipments in 2005. Likewise, according to the 2006 National Export Strategy only about 4 percent of United States companies export. The report also notes, "For the United States to remain competitive, we must engage more of the American business community in the global economy."

We need to identify the low hanging fruit and assist SMEs with the harvest. The National Export Strategy laments that:

The number of U.S. exporters has remained static in recent years. At the same time, the profile of these companies continues to evolve, in some cases making it even more difficult for the government to reach out to them on its own. The challenges the government faces include the following:

- Growth in the total number of U.S. exporters has been relatively flat over the last seven years, growing only 8.5% from 1997 to 2004
- Exporting companies make up less than 4% of all U.S. companies that have one or more employees
- SMEs' share of the value of merchandise exports has remained below 30%
- Nearly 60% of SME exporters export to only one foreign market
- Over 40% of all SME exports by value go to just four foreign markets
- Very small companies (fewer than 20 employees) account for 70% of all exporting firms
- Non-manufacturing companies (e.g. wholesalers) make up 68% of all SME exporters.

It is in our national interest to encourage exports to balance trade. Manufacturing is strategic because it creates wealth for our nation and is important to the U.S. economy. Manufacturing represented one-eighth of GDP in 2005, but competitive challenges to manufacturers are increasing. The U.S. trade deficit continues to increase even though U.S. exports grew at a vigorous rate in 2006 according to the Census Bureau. Last year, total U.S. exports grew by 12.7 percent to \$1.4 trillion, an increase of \$162.6 billion over 2005, while imports increased 10.5 percent to \$2.2 trillion.

The Administration's Export Strategy speculates that a robust domestic market has kept export levels fairly constant in recent years, but it also says companies are missing out, and here's why. First, escalating use of Internet and email, better travel connections and landline technology have significantly improved global communications. Second, tariffs in industrial countries have dropped from more than 38 percent to just 4 percent as a result of multilateral trade negotiations since 1947. And third, recent negotiations are breaking down other barriers as well. The report cautions that too much home-market emphasis may keep firms from recognizing the onset of new competition until it is too late.

SMEs need assistance to compete in foreign markets. In 2002 the Trade Promotion Coordinating Committee (TPCC) found that among U.S. small manufacturers who do not export, about 30 percent would if they had more help getting information about markets, customers, and export procedures. It found the perception of high risk and concerns over financing and shipping paperwork also play a significant role in the decision not to export. It noted that these firms are a major source of economic activity and job growth in the United States. They hold the potential for even more dynamic growth as they enter international markets. Recognizing that SMEs face a "daunting array of information and resources" it recommended more effort through public/private partnerships to demystify the process.

That's where trade missions fit in. Traveling with a contingent made up of an official from government and knowledgeable organizers who pre-arrange and vet local connections for key meetings maximizes every minute of the trip. Combining governmental meetings, company visits and university ties is a real ice breaker in foreign lands where establishing relationships comes before business deals.

Trade missions help bridge the gap in several important ways:

- Identify opportunities so our companies can take advantage of them;
- Help develop important relationships that lead to business deals;
- Enable wise use of time and money by prearranging meetings with potential customers;
- Offer opportunity to become familiar with and adapt to cultural differences so future business deals work better;
- Interact with local resources that can help reduce the learning curve, with answers to: What are the paperwork requirements? How do I get paid? How do I ship my product? Will I have to pay tariffs? Will my intellectual property be protected?

Because it can take as long as two years for a novice firm to successfully complete its first export transaction, the investment of time and resources to further relationships through participation in a trade mission offers real value. Building relationships is much more important when doing business internationally than they are when doing business domestically. Small business can be very good at building business relationships, but distance and oceans make it difficult to build contacts and trust. Assistance provided by organizations like the U.S. Commercial Service, such as the Gold Key service, are efficient and effective ways to initiate business contacts. Unfortunately, such services are expensive for U. S. companies. To make matters worse, competing nations frequently provide similar services free of charge which puts our companies at a government-created disadvantage.

### **SME Centric Recommendations**

Earlier, I discussed a number of trade barriers, most of which impact both large and small manufacturers. The Administration, Congress, and certainly this Committee are fully aware of these issues and continue working to resolve them. However, I have focused my recommendations in areas that I believe will significantly benefit small and medium sized firms, and that will allow us to tap the export potential they represent.

### **1. Support Innovation as foundational to U.S. competitiveness**

Innovation is the key to our ability to compete. This has been true since the industrial revolution. We must be vigilant and take action against anything that erodes this foundation. SMEs are recognized as an important source, perhaps the most important source, of innovation in the U.S. We need to be sure that incentives and systems that motivate and enhance our creative spirit are in place. Examples include permanent R&D tax credits, continuation of Small Business Innovation and Research (SBIR) programs. In addition, programs like the Small Business Development Centers (SBDC) who help entrepreneurs commercialize their innovations need more funding.

The NIST MEP is currently working with the private sector to develop an extensive tool set to assist SMEs with their innovation processes. Training for the MEP field staff is being developed and will soon be deployed. With MEP assistance, SMEs will have the knowledge and support they need to bring new efficiencies to identifying and developing innovative products and processes. Efforts of this nature need to be encouraged, expanded, and funded.

An example of innovative technologies that improve industrial systems is Radio Frequency Identification (RFID). The NIST MEP system partnered with the nation's Procurement Technical Assistance Centers (PTACs) to make the nation's manufacturers aware of emerging RFID standards, and the MEP system is currently positioned to deploy new information and teach companies about RFID standards and equipment. We also help manufacturers integrate the technology into their production systems to increase efficiency and into their products to meet customer needs.

### **2. Ensure Trade Agreements have transparency for standards and local regulations**

A major trade issue for SMEs concerns standards and local regulations. Foreign cities and regions often have their own standards and regulations that deal with products. Even when product specifications are clearly delineated in a contract, SMEs can run afoul with unexpected requirements. This can be an insidious form of a trade barrier because complying after the fact can cost time, money and sales.

It would be very helpful if trade agreements resolved these issues, perhaps developing a form of comity or establishing a hierarchy that can be used to resolve differences. At the very least, we should demand transparency and disclosure before contracts are signed. Foreign importers should not be allowed to hide behind these regulations to demand additional concessions after goods are delivered.

### **3. Support creation of an export guide and evaluation tool**

The small manufacturing community needs access to information in an efficient and customized manner. Web-based self assessment tools that help create a map to exporting that is specific to the company and the target market would be extremely valuable. The assessment should include suggested sources for technical assistance and it should be backed by a simple seminar that teaches the basics of international trade. An assessment tool like this can augment efforts like the following:

As part of an initiative to encourage increased exports of U.S. technology, the Maryland/Washington DC District Export Council (DEC) has teamed up with the Department of Commerce, National Institute of Standards and Technology, and the State of Maryland to offer our first "International Imperatives and Business Strategies" program for technology CEOs. Maryland CEOs who are new to exporting technology or have a plan to export products in the near future are brought together in three sessions. Participants in this course are nominated and selected from the pool of technology CEOs in the State of Maryland.

The course contents have been selected for strategic importance to the CEO. The course will end with the development of a customized strategic plan for developing exports within each of the participating companies. Through the course, experts on international trade will be drawn in to speak or assist in the development of the customized exporting plan.

I cannot commit the NIST MEP to a course of action, of course. However, I believe we need to allocate the resources to expand this pilot effort. The MEP is in a unique position to develop and distribute an export guide and evaluation tool. We have the experience, talent, knowledge, and partnerships in place to do the job effectively. We have the nation-wide distribution network that is experienced in rapid deployment. We have a track record of delivering high value.

#### **4. Enable more and affordable assistance to compete in foreign markets**

Small firms need help to become "export ready". As major markets going through new phases of industrial development, India and China are priorities for the Trade Promotion Coordinating Committee (TPCC). Central America and the Middle East are also priorities. However, small firms that are entering international markets for the first time find exporting to developing countries more difficult.

The U.S. needs to focus on developing markets like China. But at the same time we need to help small companies learn to trade in established markets like Canada and Europe before they tackle developing countries.

Asking a small manufacturer, the average of which has about 15 employees in Montana, to sell in a foreign market is like asking a middle school student to take a high school equivalency exam. Imagine the hopeless, futile feeling! Yet after additional education, the task may seem challenging yet achievable.

For small and micro-sized companies to compete in the global marketplace, a rethinking of the resource support available must be done with an eye towards what our competitor's have available from their governments, and how we can have equal footing.

SMEs in the U.S. have a significant competitive disadvantage when competing globally. Companies from G 8 countries have government economic development resources readily available to support their international marketing activities. For Example, the Canadian International Trade Authority (CITA), will pay for trade missions, provide



marketing grants, and fund company contribution to World Bank and Regional Development Bank funded projects.

While some foreign governments are paying for trade missions, making an investment in exports, the U.S. does not pay for trade missions and in some cases charges fees for service. For example the U.S. Foreign Commercial Service charges for the services that are the most beneficial to small and micro sized companies. The fee schedule will soon make it impractical for SMEs to participate.

We need to re-evaluate our approach to exports and adopt an "investment" mind-set. Flat or declining budgets for trade organizations undermine the development of skills and resources needed to grow international trade by SMEs. We should not raid the budgets of strategic centers like the U.S. Commercial Service that had a large portion its budget funneled to our Embassies to help pay for increased security since 9/11.

Currently the Export-Import Bank, Overseas Private Investment Corporation and the International Regional Development Banks, in reality, have little practical help for small and micro sized business, contrary to some of their published materials. The Trade Adjustment Assistance Program, is only funded at \$16 million annually, it should be increase significantly if we are serious about helping SMEs close the gap in the balance of trade. Clearly, a new approach is needed.

#### **5. Encourage and sponsor trade missions**

About 30 percent of non-exporters are interested in exporting and cite the lack of information about export markets, customers, and export procedures as areas where they most need help. Trade missions are an efficient way to help experienced and novice exporters alike. Traveling with a contingent made up of an official from government, experienced professionals and knowledgeable organizers who pre-arrange and vet local connections for key meetings maximizes every minute of the trip. Combining governmental meetings, company visits and university ties is a real ice breaker in foreign lands where establishing relationships comes before business deals.

Trade missions help identify opportunities and develop important relationships that lead to business deals. They are an efficient and wise use of time and money because meetings are prearranged and potential customers are vetted. With a Senator, Congressman, Governor, or other governmental official leading the mission, it is easier to interact with local resources that can cut red tape, and professionals traveling with the mission can get answers to questions like: What are the paperwork requirements? How do I get paid? How do I ship my product? Will I have to pay tariffs? Will my intellectual property be protected?

Chairman Baucus, Ranking Member Grassley, and Committee Members, thank you for this opportunity, your time, and for all you are doing for the Nation's small and medium sized manufacturers.